

LEGAL SERVICES CORPORATION

3333 K Street, NW 3rd Floor
Washington, D.C. 20007-3522

In re

INLAND COUNTIES LEGAL SERVICES, INC.
(Recipient No. 805230)

Chair: George S. Theios
Executive Director: Irene C. Morales

Notice of Questioned Costs
Date: January 29, 2014

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MANAGEMENT DECISION

After careful consideration, the Legal Services Corporation (“LSC”), in accordance with 45 CFR Part 1630, has determined that Inland Counties Legal Services, Inc.’s (“ICLS”) expenditure of LSC funds totaling \$252,069.33 in stipend and other benefits payments in 2009 and 2010 is unallowable. LSC’s decision to disallow these costs, the rationale for the decision, and the accompanying required corrective actions are provided below.

BACKGROUND

Pursuant to 45 CFR Part 1630, LSC's Office of Compliance and Enforcement ("OCE"), by Notice of Questioned Cost (the "Notice") dated September 30, 2013, advised ICLS of its intent to disallow ICLS' expenditure of LSC funds totaling \$252,069.33. (A copy of the Notice is attached hereto as Exhibit A.)

Based on findings by LSC's Office of the Inspector General ("OIG"), the Notice advised ICLS that its 2009 and 2010 expenditure of LSC funds for the payment of stipend and other benefit payments was an unreasonable and unnecessary expenditure. In particular, citing 45 CFR § 1630.3(c) and the Accounting Guide for LSC Recipients (2010 Ed.), § 2-3.2, the Notice advised ICLS that the allocation of the payments exclusively to its LSC fund was inconsistent with the restraints or requirements imposed by LSC regulations and instructions, and was less than prudent considering ICLS' responsibilities to LSC.

The Notice observed that as salary adjustments, unless all of the activities of all of the employees who received LSC funded stipend and other benefit payments during the years in question could have been supported by ICLS' LSC grant, ICLS could not appropriately allocate the stipend and other benefits payments exclusively to its LSC award. The Notice further observed that information available to LSC concerning ICLS' activities during the years in question indicated that all of its activities could not have been supported by its LSC grant. Accordingly, the Notice concluded that LSC funded stipend and other benefits payments on the basis of salary costs that could not have been allocated to ICLS' LSC grant was inconsistent with 45 CFR § 1630.3 (c) and, consequently, unreasonable. The Notice instructed ICLS that stipend and other benefits payments to employees who engaged in activities that could not have been supported by LSC funds should not have been allocated to ICLS' LSC grant at all. As well,

stipend and other benefits payments to employees who engaged in both activities that could have been supported by LSC as well as activities that could not have been supported by LSC should not have been allocated to ICLS' LSC grant alone, but should have been apportioned among its grant sources. Similarly, stipend and other benefits payments to ICLS management, financial administration, human resources, information technology, support staff, etc. should have been apportioned among ICLS' grants in the same manner as salary costs were allocated.

As a percentage of revenue received during the years in question, the Notice calculated the portion of the stipend and other benefits payments that should not have been allocated to ICLS' LSC grant. Consequently, the Notice advised ICLS that as it derived 68.5% of its total funding from LSC in 2009, and 66.6% in 2010, 31.5% (\$106,114.99) of the total 2009 stipend and other benefit payments should have been allocated to its non-LSC awards, and 33.4% (\$145,954.33) in 2010, for a total of \$252,069.33.

By letters dated November 2, and December 2, 2013, ICLS responded with evidence and argument to show that the unallowable cost is less than that stated in the Notice, and that for equitable, practical, or other reasons; LSC should not recover all or part of the amount. (Copies of ICLS' December 2 and November 2, 2013 responses are attached hereto as Exhibit B.)

Essentially, ICLS argued that the payments were not prohibited, that they were reasonable and necessary, and, therefore, the costs were properly allocated to its LSC award. ICLS did agree that stipend and other benefits payments to employees who engaged exclusively in activities that could not have been supported by its LSC fund should not have been so allocated, and identified two (2) such employees. ICLS conceded that the \$18,467.38 paid to the two (2) employees during the years in question is unallowable. Otherwise, ICLS argued that the activities of all or nearly all, other staff during the years in question could have been supported

by its LSC award and, consequently, allocation of the payments to its LSC fund was not inappropriate.

ICLS submitted grant documents and case and other services activities reports in an attempt to demonstrate that for the years in question, a larger percentage of the stipend and other benefits payments were allocable to its LSC fund than the percentages stated in the Notice. In particular, ICLS argued that the stipend and other benefits payments associated with its non-LSC funded activities benefited both its LSC award and other grants and is, therefore, allocable to its LSC grant consistent with 45 CFR § 16303(c)(2). Based on these arguments, ICLS submitted varying calculations of the unallowable cost ranging from \$23,215.86 to \$104,645.82 for both years.¹

DISCUSSION AND ANALYSIS

LSC is a federally funded, private, non-membership, nonprofit corporation, organized under the laws of the District of Columbia. Established by the Legal Services Corporation Act of 1974, 42 USC §§ 2996 *et seq.*, as amended, H.R. 6666, Pub. L. 95-222 (December 28, 1977) (the “LSC Act”), LSC is authorized to, among other things, provide financial assistance to qualified programs furnishing legal assistance to eligible clients, and to make grants to and contracts with other entities for the purpose of providing legal assistance to clients eligible for such assistance under the LSC Act. *See* 42 USC § 2996e(a)(1)(A). LSC also has authority to ensure that its grant recipients comply with the rules, regulations, and guidelines promulgated by LSC pursuant to the LSC Act. *See* 42 USC § 2996e(b)(1)(A).

In 2009 and 2010, ICLS received funding from LSC for the purpose of providing legal assistance to clients eligible for such assistance under the LSC Act residing in Riverside and San

¹ LSC notes that some of the calculations in ICLS’ responses contained errors. In an effort to determine accurately the amount of the questioned cost, LSC has corrected the errors as reflected herein. As such, the figures cited herein may appear different from those contained in ICLS’ responses.

Bernadino counties, located in southeastern California. For each of these years, ICLS agreed to comply with the requirements of the LSC Act and regulations, any and all applicable appropriations acts, and any other applicable law, rules, regulations, policies, guidelines, instructions, and other LSC directives, including, but not limited to, LSC Audit Guide for Recipients and Auditors, the Accounting Guide (2010 Edition), the CSR Handbook (2008 Edition, as amended 2011), the 1981 LSC Property Manual (as amended) and the Property Acquisition and Management Manual, and with any amendments of the foregoing adopted before or during the period of this grant.

Generally, costs or expenditures incurred by a recipient are allowable under the recipient's LSC grant or contract. However, LSC may question the allowability of such costs where there may have been a violation of a provision of law, regulation, contract, grant, or other agreement or document governing the use of LSC funds, where the cost is not supported by adequate documentation, or where the cost appears unnecessary or unreasonable and does not reflect the actions of a prudent person under the circumstances. *See* 45 CFR § 1630.2(g). In the event that LSC determines that the expenditure should not be charged to the recipient's LSC fund, the cost may be disallowed. *See* 45 CFR § 1630.2(d). Where LSC has questioned the allowability of a cost, it is incumbent upon the recipient to demonstrate that the cost is allowable under the recipient's grant or contract. *See* 45 CFR §§ 1630.3 and 1630.4.

LSC regulations set forth standards governing the allowability of costs charged to a recipient's LSC grant or contract. *See* 45 CFR § 1630.3. A recipient's expenditures are allowable under its LSC grant or contract only if the recipient can demonstrate that the cost was, among other things, reasonable and necessary to the performance of the LSC grant, allocable to

its LSC grant, and compliant with LSC regulations and instructions and the Accounting Guide for LSC Recipients (2010 Ed.). *See* 45 CFR §§ 1630.3(a)(2), 1630.3(a)(3) and 1630.3(a)(4).

The concept of reasonableness applies both to the amount of the cost and to the nature of the activity that the cost represents. In determining the reasonableness of a given cost, LSC regulations enumerate four (4) considerations, including the restraints or requirements imposed by LSC regulations. *See* 45 CFR § 1630.3(b).

LSC regulations also set forth considerations governing the allocation of costs charged to a recipient's LSC grant. The regulations provide that a cost is allocable to a particular grant to the extent that it "benefits" the grant. Costs may be allocated to a recipient's LSC award, either as a direct or an indirect cost in accordance with LSC regulations. *See* 45 CFR § 1630.3(c). Recipients are instructed that direct cost, *i.e.*, those that can be identified specifically with a particular grant, are to be allocated to the particular grant. *See* 45 CFR § 1630.3(d). Where the recipient has one major function, such as the delivery of legal assistance to low-income clients, allocation of indirect costs, *i.e.*, those costs that have been incurred for joint or common objectives and cannot be readily identified with a particular grant, may be by simplified allocation method, whereby total allowable indirect costs are divided by an equitable distribution base and distributed to individual grant awards accordingly. The distribution base may be total direct costs, direct salaries and wages, attorney hours, numbers of cases, numbers of employees, or another base which results in an equitable distribution of indirect costs among funding sources so as not to distort grant costs. *See* 45 CFR § 1630.3(f).

In considering ICLS' response to the Notice, any argument that LSC has never, either by regulation, policy directive, or other guidance, advised recipients that expenditures of LSC funds must be reasonable and necessary is baseless. LSC's regulatory requirements apply to all

expenditures of LSC funds, including stipend payments. Similarly, regardless of whether ICLS provided information concerning the stipend payments to various LSC offices over the years, there is a legal and factual basis for disallowing the costs, and, as such, this action is appropriate. LSC, by this action, is not announcing a policy on stipends, but rather is, by this action, doing precisely what ICLS requested - clarifying LSC's expectations and ICLS' obligations relative to the expenditure of LSC funds.

Contrary to ICLS' assertions, the Notice did not question either the stipend and other benefits payments, or the amount of the payments. Indeed, the Notice acknowledged ICLS' stipend and other benefits payments as a form of allowable incentive compensation. *See* OMB Circular A-122, App. B., 8.j. Rather, the Notice advised ICLS that its allocation of the expenditure exclusively to its LSC grant was inconsistent with the aforementioned restraints or requirements imposed by LSC, and that the expenditure should have been allocated among ICLS' grants. The Notice was specifically directed at the allocation of the entire stipend and other benefits expenditure to ICLS' LSC grant.

Nor is LSC persuaded that a larger percentage of the stipend and other benefits payments were allocable to ICLS' LSC award than the percentages stated in the Notice. In response to the Notice, ICLS argued that all, or nearly all, of its non-LSC funded activities benefitted its LSC grant. ICLS asserted that all of its 2009 and 2010 Title III activities could have been supported by LSC funds. Citing a July 30, 1980 LSC Office of the General Counsel ("OGC") opinion, ICLS argued that LSC funds are permitted to be used to satisfy the non-federal share requirement of the Older Americans Act of 1965. According to ICLS, if a recipient suffers Title III funding cuts, LSC funds may be used to fund the Title III cases. Similarly, where an advocate resigns or takes a leave of absence, the client case load may be reassigned to an LSC funded advocate.

ICLS stated that there is no prohibition on shifting costs to avoid funding deficiencies or restrictions on the use of funds. Accordingly, ICLS concluded that all of its 2009 and 2010 Title III grant revenue was expended on LSC permissible activities.

ICLS also asserted that 67% of its 2009 IOLTA activities and 73% of its 2010 IOLTA activities, 94% of its 2009 and 2010 Equal Access Fund (“EAF”) activities, and 98% of its 2009 and 2010 HUD activities could have been supported by its LSC grant. Further, on the basis of grant documents submitted with its response to the Notice, ICLS contended that grant funds received from Riverside County, Kaiser Permanente, and its partnership grants from the State Bar Trust Fund during the years in question were used to engage in permissible other services activities that also benefitted its LSC award.

ICLS then calculated the amount of the questioned costs by first adding these percentages of its IOLTA, EAF and HUD awards, as well as the total amounts of its Title III, Riverside County, Kaiser, and partnership grants to its LSC award. This figure, according to ICLS, represents the total LSC award. ICLS then totaled the remaining percentages of its IOLTA, EAF and HUD awards to arrive at the total non-LSC award. According to ICLS, as a percentage of its total LSC award, non-LSC awards accounted for 3% in 2009 and 2010. Consequently, the total unallowable cost is 3% of the 2009 stipend and other benefits payments (\$10,106.19) and 3% of the 2010 payments (\$13,109.67), for a total of \$23,215.86.

Alternatively, ICLS stated that only 3% of its Title III activities could have been supported by LSC funds and acknowledged that \$18,467.38 in stipend and other benefits payments on the basis of salary costs that could not have been allocated to its LSC award should not have been allocated to its LSC grant. The alternative calculation was otherwise the same as previously discussed and ICLS calculated that 6.5% of the 2009 stipend and other benefits

payments (\$21,896.75) and 7% of the 2010 payments (\$30,589.23), for a total of \$52,485.98, is unallowable.

In response to OCE's request for additional information, ICLS, by letter dated December 2, 2013, submitted a third calculation totaling \$104,645.82. In its third calculation, ICLS included the results of its efforts to identify the stipend and other benefits payments associated with non-case and other services activities, otherwise ICLS calculated the unallowable costs in the same manner as its first calculation.

ICLS explained that its third calculation was based upon an examination of the case management time records for all administrative and support staff that had been exported from the case management system to individual Excel spreadsheets. The Excel filter functions were applied to exclude other services, or "matters", and supporting activities. Time entries that had client case numbers were highlighted and included as direct costs. Case note entries made by administrative or support staff were reviewed to verify the activity was in fact case related.

In its third calculation, assuming that all Title III activities could have been supported by ICLS' LSC award and excluding the payments to the two (2) employees that concededly should not have been allocated to its LSC fund, ICLS' stated that \$48,458.74 of the 2009 stipend and other benefits payments should have been allocated to its non-LSC funds, and \$56,187.08 in 2010 for a total of \$105,245.82.

LSC funds are not so unique or peculiar that they do not benefit from activities supported by other grants. In many instances, a recipient's non-LSC funded activities also benefit its LSC award. For example, non-LSC funded legal assistance provided to a financially eligible US citizen or eligible alien that is within the recipient's priorities and is not otherwise prohibited by the LSC Act or inconsistent with Section 504, 110 Stat. 1321 (1996) is reportable in the

recipient's CSR data submission and, thus, benefits the recipient's LSC award. *See* CSR Handbook (2008 Ed., as amended 2011), § 2.1. Non-LSC funded direct delivery of legal assistance to eligible clients by private attorneys, as well as non-LSC funded support provided by private attorneys to recipients in the delivery of legal assistance to eligible clients, also benefits the recipient's LSC award. *See* 45 CFR Part 1614. Similarly, non-LSC funded other services activities that contribute to the overall delivery of legal services, *e.g.*, community education presentations, pro se clinics, continuing legal education, providing information about the availability of legal assistance, training, general supervision of program services, etc., also benefits the recipient's LSC award. *See* 45 CFR §§ 1620.2 and 1635.2(d).

However, ICLS' Title III argument ignores LSC Program Letter 01-5, "Elimination of Exception to CSR Financial Eligibility Documentation Requirement Effective Calendar Year 2002" (July 25, 2001), in which LSC instructed recipients that, effective January 1, 2002, cases lacking a financial eligibility determination may no longer be included in the recipient's CSR data submission. LSC regulations require recipients to maintain such records as may be necessary to demonstrate its compliance. *See* 45 CFR § 1611.5(b). Unlike LSC funded case activity, Title III case activity is not limited by documentation of financial eligibility. Indeed, the case lists generated by ICLS for its unreported Title III cases indicate activities involving very few persons whose were financially eligible for LSC-funded legal assistance.² *See* ICLS' November 2, 2013 response, Attachment Nos. 13 and 14.

² Absent asset ceiling waivers and/or documentation of ICLS' consideration of an authorized exception adopted by its governing body as part of its financial eligibility policy, LSC's consideration of the materials submitted by ICLS was limited to activities involving persons whose income was at or below 125% of the Federal Poverty Guidelines ("FPG") and whose assets did not exceed ICLS' asset ceiling of \$20,000.00.

ICLS also argues that its Title III grants were limited to reimbursement of salaries based on services provided and, as such, it was prohibited from charging any portion of the stipend and other benefits payments to such grants. LSC regulations acknowledge that some grants, such as fee-for service contracts and cost reimbursable awards, may not permit allocation of certain costs. In such instances, recipients may allocate a proportional share of another funding source's share of the cost to its LSC fund, but only to the extent that the activity associated with the costs is permissible under the LSC Act and regulations. *See* 45 CFR § 1630.3(g). In contrast to the cost reimbursable revenue ICLS received to provide legal assistance to low-income, disabled persons seeking to establish eligibility for Supplemental Security Income, the materials provided by ICLS indicate that a good deal of its cost reimbursable Title IIIB grant funded activities could not have been funded by its LSC award. Indeed, ICLS' alternative calculation concedes that only a small percentage of its Title III funded activity benefited is LSC grant.

ICLS' argument that a large percentage of its IOLTA, EAF and HUD supported case activities could have been supported by its LSC grant is also unpersuasive. The materials that ICLS provided in support of such argument are insufficient to demonstrate that the case activities could have been supported by its LSC grant. Unlike the case service materials provided in support of its Title III contention, which arguably provide a basis for the percentage claimed by ICLS, the materials provided in support of ICLS' IOLTA, EAF and HUD arguments are simply the numbers of cases closed in the various CSR Legal Problem Categories. Precisely how ICLS arrived at the percentages is unclear.

LSC notes further that ICLS' calculation of the questioned costs is flawed in several respects. Specifically, the November 2, 2013 re-calculations are based on inflated figures. ICLS

recalculates the amount of the 2009 and 2010 questioned costs using the total LSC funding figure found in its Grant Activity Reports (“GAR”). ICLS then adds amounts, *e.g.*, interest income, fund balance, contributions, *cy pres* awards, publication income, etc., that are already included in the GAR total LSC funding figure, thus inflating total LSC funding. Additionally, its December calculations are limited to case activity of program administration and support staff.

By letter dated November 8, 2013, ICLS was advised that assuming its November 2 calculations addressed the case and other services activities of its attorneys and paralegals, it neglected to address the supporting activities of program administration and support staff. As previously noted, ICLS responded by letter dated December 2, 2013 stating that it examined the time records of such staff, but excluded time expended by such staff on matters and supporting activities. Consequently, ICLS’ December 2 calculations represent only the case activities of program administration and support staff.

To the extent that ICLS argues that a larger percentage of its non-LSC funded activities could have been supported by its LSC award, it bears the burden of demonstrating by a preponderance of the evidence that, with regard to case activity, the activities involved legal assistance to a financially eligible US citizen or eligible alien that is within the recipient’s priorities and that is not otherwise prohibited by the LSC Act or inconsistent with Section 504, 110 Stat. 1321 (1996). Regarding non-LSC funded other services, or “matters”, and/or supporting activities, it bears the burden of demonstrating that such activities conform to 45 CFR §§ 1635.2(a) and (b). Neither ICLS’ arguments, nor the materials that it provided in support thereof are sufficient to meet its burden.

ICLS’ arguments and the materials it provided ignore the fact that LSC regulations instruct recipients that costs that have a common or joint objective are to be allocated equitably

among the recipient's individual grant awards. *See* 45 CFR §§ 1630.3(e) and 1630.3(f). In other words, costs – such as ICLS' LSC, IOLTA, Title III, EAF or HUD funded salary costs - that benefit a recipient's LSC award and its non-LSC awards should not be charged exclusively to its LSC award. Rather, such costs should be distributed equitably among the recipients grant sources. To do otherwise distorts the costs of both its LSC and non-LSC awards.

In view of the instructions provided by the regulations, LSC flatly rejects the notion that ICLS understood that it was appropriate to allocate the entire stipend and other benefit payments to its LSC fund, particularly where the staff and/or the activities they engaged in benefitted more than its LSC grant.³ Such notion is contrary to 45 CFR § 1630.3(c)(2), which instructs recipients that costs are allocable to a recipient's LSC grant if, among other things, it benefits both the LSC grant and other work and can be distributed in reasonable proportion to the benefits received.

CONCLUSION

For the foregoing reasons, LSC has determined that ICLS has failed to demonstrate that the cost was allowable, or that LSC should not recover all or part of the amount stated in the Notice. Accordingly, LSC has determined that \$106,114.99 of the 2009 stipend and other benefits payments is unallowable, and \$145,954.33 of the 2010 payments for a total of \$252,069.32, to be recovered by LSC by monthly deductions from ICLS' grant check beginning in February 2014 and continuing until such time as full amount stated herein is recovered.

³ LSC also notes that ICLS identified a 2009 non-LSC fund balance totaling \$183,017.00 and a 2010 non-LSC fund balance totaling \$205,784.00, but neglects to explain why none of the stipend and other benefits payments were allocated to these sums.

In accordance with 45 CFR § 1630.7(e), ICLS may appeal, in writing, to the President of LSC within thirty (30) days of receipt of this decision. The written appeal should state in detail the reasons why LSC should not disallow part or all of the questioned cost.

Dated: January 29, 2014

LEGAL SERVICES CORPORATION



Lynn A. Jennings
Vice President for Grants Management